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C O N F I D E N T I A L ANKARA 008728

SIPDIS

TREASURY FOR OASIA - MILLS

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SUBJECT: EMBASSY RAISES PAMUKBANK CASE WITH AK VICE CHAIRMAN

REF: ANKARA 8596

Classified by Economic Counselor Scot Marciel. Reasons: 1.5 (d).

1. (C) We met November 29 with AK Vice Chairman and MP Murat Mercan to highlight the risks resulting from the Danistay's November 22 injunction against BRSA's takeover of insolvent Pamukbank. We said the decision, although taken by an independent judicial body, undermined the BRSA's credibility and added to the fragility of Turkey's already-weak banking sector -- problems the government would have to address. Moreover, it coincided with AK criticisms of the BRSA, a proposal by 20 AK MPs that Parliament investigate BRSA's takeover of Pamukbank, and senior-level AK meetings with Mehmet Karamehmet, owner (through Cukurova Group) of Pamukbank and of 45 percent of Yapi Kredi Bank. As a result, markets were voicing concern about the new government's commitment to further bank reform.

2. (C) Mercan, who is close to Prime Minister Gul, listened carefully but evinced some skepticism about the legitimacy of the Pamukbank takeover. For example, he asked why BRSA did not take over other weak banks, such as Isbank. We responded that he would hear mixed views from the markets on other banks, but that there was a consensus in the financial community that Karamehmet had managed Pamukbank into insolvency and that the BRSA was right to take it over. We also noted strong support for the new government's pledge to combat corruption, and suggested that cleaning up the banking system was an integral part of that effort.

3. (C) Mercan asked what we thought the government should do. We said that was up to the GOT to decide, but we thought the markets would welcome -- as a first step -- a strong public statement making clear that the government was committed to further bank reform, would not bail out poorly-managed banks, and fully supported an independent BRSA. The GOT would also need to consider steps to address the short-term threat to the banking system posed by the return of insolvent Pamukbank and nearly-insolvent Yapi Kredi Bank to the Cukurova Group's control.

4. (C) Comment: Key players in AK Party have met a number of times with Karamehmet (Mercan said Party Chairman Erdogan had met with him three times), but have not spoken with BRSA officials. They have bought Karamehmet's allegations that BRSA's takeover of Pamukbank was politically-inspired and unjust. That belief is behind AK's sharp criticism's of BRSA over the past few months, and probably explains the government's weak response to last Friday's Danistay decision. Now that the financial community and the press -- notably the Financial Times in its November 18 editorial -- have begun to express concerns about the Danistay decision and about AK's commitment to banking reform, we hope the government will re-think its views. One positive note: Deputy Prime Minister Abdullatif Sener (who oversees BRSA and initially responded to the Danistay decision by telling BRSA that it was "their problem") and State Minister Ali Babacan have called BRSA President Engin Akcakoca in to brief them for the first time.

DEUTSCH